HOSPITAL CHARITY CARE IN TEXAS

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Key Points

- Nationally, nonprofit hospitals receive a federal income tax exemption so long as they provide a benefit to the community, as defined by Section 501(c)(3) of the Internal Revenue Code.
- Texas nonprofit hospitals receive a state property tax exemption in exchange for providing charity care to their community.
- Compared to for-profit hospitals, Texas nonprofit hospitals provide less charity care to the community—despite benefitting from a tax-exempt status.

Executive Summary

Nonprofit hospitals, incentivized by tax exemption both federally and often at the state level, are required to provide a benefit to the community in the form of discounted care to the uninsured and underinsured. Yet, millions of Americans continue to accumulate unpaid medical debt. Section 501(c)(3) of the Internal Revenue Code defines the qualifications an organization such as a hospital must meet in order to receive tax exemption. One of the requirements is that a hospital must provide a community benefit to the population it serves. Measuring this benefit to determine whether or not a hospital meets a level of benefit high enough to justify the tax exemption can be difficult and based off a number of factors. To determine whether Texas nonprofit hospitals are providing enough community benefit to justify a tax exempt status, this study looks at the amount of charity care, or cost-free care, they provide to the individuals of the community at no or reduced charge to the patient.

The Johns Hopkins Carey Business School (Bai et al., 2020) recently analyzed the charity care provided to communities across the United States at nonprofit hospitals both with great net incomes and with very low net incomes. They found that nationally, those hospitals with the greatest net incomes provide far less charity than those with much lower net incomes. This study shed light on various questions surrounding nonprofit hospitals: Are they truly providing enough charity care to the community to qualify for a tax-exemption? How does the cost of the charity care provided to the community compare to the value of the tax exemptions received? How does the charity care provided by nonprofit hospitals compare to that of for-profit hospitals that do not receive any tax incentive to provide such care?

This study attempted to answer those questions based on the charity care nonprofit hospitals provide in Texas. The raw data that we at the Texas Public Policy Foundation analyzed was compiled by Rice University's Baker Institute and consisted of the following variables for 369 Texas hospitals: net patient revenue, operating expenses, charity care, charity care payments, charity care grants, uninsured and bad debt cost. Significant among these variables are the charity care grants. Grants are awarded to hospitals by both private donors and endowments as well as from the government as additional funding for those who cannot afford medical care. Therefore, when calculating whether or not a hospital is providing charity care that meets or exceeds the dollar amount they would have paid in taxes if not for their exemption, a distinction must be made with and without the inclusion of charity care grants.

We categorized the 369 hospitals with their statistics by profit status, rural status, and price transparency compliance status. We found that while nonprofit hospitals in Texas do provide more charity care—about 43%—than for-profit hospitals before accounting for grants, after accounting for grants, there is only a 1.67% difference in the charity care spending

of nonprofit versus for-profit hospitals. This means that Texas for-profit hospitals that do not receive tax-exempt status are providing charity care at rates nearly equal to those of nonprofit hospitals that receive tax exemptions. In addition, these nonprofit hospitals are significantly less efficient with their charity care spending. Our study found that 1 dollar of charity care spending goes 27% further in a for-profit hospital than in a nonprofit hospital; in other words, a nonprofit hospital is less than 80% as efficient as a for-profit hospital.

According to Texas Tax Code §11.18(d)(1), Texas is required to provide charity care at an amount that totals at least 100% of the tax-exempt benefit received by the hospital. Texas should enforce its current laws that require charity care spending of hospitals to account for a dollar value equal to or higher than their tax exemption.

Introduction

Medical debt is a scourge to the financial stability and credit strength of millions of individuals in this country. As of March 2022, 23 million Americans—about 7 % of the population—owed at least $250 in medical debt (Plescia, 2022; Rae et al., 2022). Of these 23 million, 11 million have compiled more than $2,000 in unpaid medical care. The inability to pay medical debt has left millions of Americans with their financial credibility in shambles, as unpaid bills are sent to collections, often times before an individual has even had the chance to pay (Rau, 2019). Not only does this affect their credit score, but it also deters individuals from pursing medical care in the future.

The Internal Revenue Service (IRS) grants nonprofit, tax-exempt status to hospitals across the nation under the agreement that they provide charity care—medical care provided to a patient from a hospital that incurs no or reduced cost to the patient—to uninsured and underinsured individuals in their communities. This agreement is statutorily outlined in the Internal Revenue Code (IRC) Section 501(c)(3), Section 501(r), and Revenue Ruling 69-545.

While Section 501(c)(3) lays out the generic requirements for any organization that is religious, charitable, scientific, literary, or educational, and that seeks federal tax-exempt status, Section 501(r) and Rev. Rul. 69-545 define qualifications specifically for hospitals. Section 501(c)(3) requires that a hospital "demonstrate that it provides benefits to a class of persons that is broad enough to benefit the community, and operate to serve a public rather than a private interest" (IRS, 2021a, para. 10). Additionally, the following factors are listed in Rev. Rul. 69-545 for consideration in determining whether the hospital provides the required benefits to the community.

- Operating an emergency room open to all, regardless of ability to pay
- Maintaining a board of directors drawn from the community
- Maintaining an open medical staff policy
- Providing hospital care for all patients able to pay, including those who pay their bills through public programs such as Medicaid and Medicare
- Using surplus funds to improve facilities, equipment, and patient care
- Using surplus funds to advance medical training, education, and research. (IRS, 2021a, para. 19)

While no one of these factors is alone determinative if a hospital is meeting the community benefit standard, if these hospitals do not provide the community benefit required, the IRS may revoke their tax-exempt status (IRS, 2021a; IRS, 2021b).

Once approved, the hospital enjoys tax-exempt status and in exchange agrees to provide care at no or reduced cost to those in their community who are either uninsured or underinsured. This care has become known as charity care, and the cost absorbed by the hospital for this care has been made the metric for measuring the community benefit required of nonprofit hospitals. Because tax exemption is given to these hospitals in exchange for providing a community benefit, the total cost of their provided charity care would, presumably, be proportional to the dollar amount of the foregone tax revenue, providing the community with a net benefit. Examining whether this is how nonprofit hospitals are functioning, many researchers are beginning to ask the following questions: Are nonprofit hospitals providing enough charity care to the community that would satisfy the community benefit statutorily required of them to be tax-exempt? Does the cost of the charity care provided to the community exceed the value of the tax exemptions received? How does the charity care provided by nonprofit hospitals compare to that of for-profit hospitals that do not receive any tax incentive to provide such care?

A recent Johns Hopkins Carey Business School study (Bai et al., 2020) of all hospitals found that, nationally, nonprofit hospitals with the greatest net income provide far less charity care than those with much lower net income.

Table 1
Definitions According to Texas Administrative Code § 13.13

Term	Definition
Charity care	The unreimbursed cost to a hospital of providing, funding, or otherwise financially supporting health care services on an inpatient or outpatient basis to a person classified by the hospital as financially or medically indigent and/or providing, funding or otherwise financially supporting health care services provided to financially indigent persons through other nonprofit or public outpatient clinics, hospitals or health care organizations.
Community benefit	The unreimbursed cost to a hospital of providing charity care, government-sponsored indigent health care, donations, education, government-sponsored program services, research, and subsidized health services. Community benefits do not include the cost to the hospital of paying any taxes or other governmental assessments.
Tax exempt benefits	All of the following, calculated in accordance with standard accounting principles for hospitals for tax purposes using the applicable statutes, rules and regulations regarding the calculation of these taxes: (A) the dollar amount of federal, state, and local taxes foregone by a nonprofit hospital and its nonprofit supporting entities. For purposes of this definition federal, state, and local taxes include income, franchise, ad valorem, and sales taxes; (B) the dollar amount of contributions received by a nonprofit hospital and its nonprofit supporting entities; and (C) the value of tax-exempt bond financing received by a nonprofit hospital and its nonprofit supporting entities.

Note. Definition are from Texas Administrative Code Section 13.13 (https://texreg.sos.state.tx.us/public/readtac$ext.TacPage?sl=R&app=9&p_dir=&p_rloc=&p_tloc=&p_ploc=&pg=1&p_tac=&ti=25&pt=1&ch=13&rl=13).

Specifically, the study produced these results:

> In 2017, US nonprofit hospitals generated $47.9 billion overall net income and provided $9.7 billion of charity care to uninsured patients and $4.5 billion of charity care to insured patients. The top quartile of hospitals generated all (100.2%) of total overall net income (the remaining hospitals had net losses in aggregation) and provided more than half—57.3% (uninsured) and 54.6% (insured)—of total charity care. In contrast, the bottom quartile of hospitals incurred losses equivalent to 15.8% of total overall net income, while providing 17.1% (uninsured) and 17.7% (insured) of total charity care. (Bai et al., 2020, p. 606)

While the bottom quartile of hospitals provided charity care totaling more than their overall income, therefore more than satisfying the community benefit required of them, the proportionality of total charity care to total overall net income in the top quartile of hospitals was drastically different. The great discrepancy in the charity care provided nationally by nonprofit hospitals analyzed in the Johns Hopkins study compared to their net benefit calls into question whether or not the level of charity care being performed by hospitals is sufficient to maintain their tax-exempt status. Because each state has its own additional requirements for tax exemption, it is important to look also at this predicament state by state.

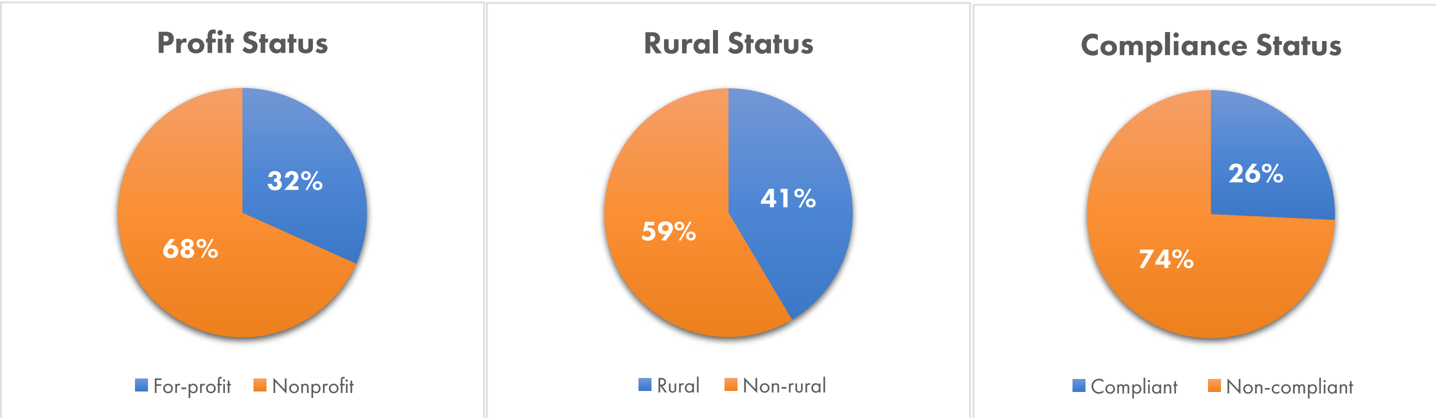
The research that follows delves into the charity care provided by nonprofit and for-profit hospitals in Texas.

Tax-Exempt Status in Texas

In addition to the federal requirements of Internal Revenue Code Section 501(c)(3) and Rev. Rul. 69-545 to qualify for federal income tax exemption, Texas state law explicitly spells out the standards hospitals must meet to be granted state tax-exempt status. Texas statute also provides definitions in Texas Administrative Code § 13.13 for the terms listed in **Table 1**, which helps further clarify their adherence to what the state requires of them in order to qualify for property tax exemption.

Using these definitions, Texas Tax Code §11.18(d)(1) states that nonprofit hospitals are exempt from property taxes if those hospitals provide "medical care without regard to the beneficiaries' ability to pay, which in the case of a nonprofit hospital or hospital system means providing charity care and community benefits in accordance with Section 11.1801." Because these requirements are even more narrow than the requirements to qualify for nonprofit status at the federal level, a hospital that follows this criterion would also be considered nonprofit according to both federal statute and state law.

Figure 1
Composition of Texas Hospitals



Variable	Number of Hospitals	Percent of Hospitals
For-profit	117	31.7%
Nonprofit	252	68.3%
Rural	153	41.5%
Non-rural	216	58.5%
Compliant	95	25.7%

Note. Produced using data from personal communication, Baker Institute at Rice University, March 2022, Turquoise Health, March 2022, and authors' calculations.

Section 11.1801 states that a nonprofit hospital is required to provide charity care and community benefit enough to meet the following qualifications:

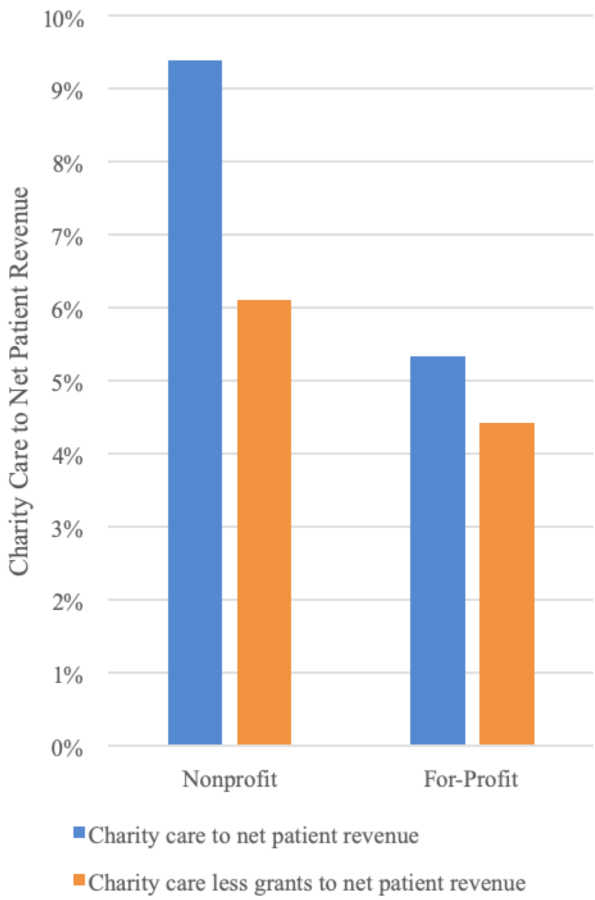
- The level of charity care and community benefit provided must be "reasonable" as compared to community need, hospital resources, and tax-exempt benefit (Texas Tax Code, Section 11.1801).
- The amount spent on charity care and government-sponsored indigent care must total at least 4% of the hospital's net patient revenue.
- The amount spent on charity care and government-sponsored indigent care must total at least 100% of the tax-exempt benefit received by the hospital.
- The hospital's provided community benefit must total at least 5% of its net patient revenue.

If a nonprofit hospital is not meeting these requirements, it is at risk of losing its tax-exempt status. Section 11.1801 explains that when discovered in violation of these requirements, a hospital will have the opportunity to resolve "miscalculations in the fiscal year following the fiscal year the failure is discovered," before its tax exempt status is revoked.

Analyzed Hospital Market in Texas

Texas is home to more than 500 hospitals, more than any other state in the nation (KFF, 2020). Each year, the Centers for Medicare and Medicaid Services (CMS) requires all Medicare-certified hospitals to file an annual MCR, or Medicare Cost Report, to the Healthcare Cost Report Information System (HCRIS; National Academy for State Health Policy, 2022). Using these reports and the resource of the National Academy for State Health Policy (NASHP), Rice University's Baker Institute compiled a list of the following variables—as they are necessary for determining proportionality between hospital revenue and charity care—for the 369 hospitals in the state of Texas that provide Medicare/Medicaid services to patients: net patient revenue, operating expenses, charity care, charity care payments, charity care grants, and uninsured and bad debt costs. Charity care grants are significant here, as they are awarded to hospitals by both private donors and endowments as well as from the government and provide additional funding for those who cannot afford medical care. Therefore, when determining a hospital's compliance with the requirement to provide charity care which totals 100% of their tax-exempt benefit, it is important to remove the amount of charity care a hospital provides using grants.

Figure 2
Adjusted Charity Care Ratios



Note. Produced using data from personal communication, Baker Institute at Rice University, March 2022, and authors' calculations.

In addition to these variables, we analyzed these 369 hospitals for their status as for-profit or nonprofit, rural or non-rural,[1] and compliant or non-compliant[2] to the price transparency rules implemented in Texas in September 2021(SB 1137, 2021). The compilation of this data can be seen in **Figure 1**. These variables were chosen to answer the following questions: how does the amount of charity care[3] provided by nonprofit hospitals compare to that of for-profit hospitals; does a hospital's location in a rural or non-rural community influence its amount of charity care; does a hospital's compliance with price transparency rules correlate to its compliance with charity care rules in Texas?

A Closer Look

Examining just charity care and net patient revenue provided the skewed results that follow. Both classifications of hospitals, for-profit and nonprofit, receive grants that partially offset the expense of charity care. If those grants are removed, the ratios change dramatically. To start, nonprofit hospitals report that charity care represents 9.39% of their net patient revenue, while for-profits report charity equal to 5.34% of their net patient revenue. Thus, for-profit hospitals appear to provide 43% less charity care, proportionally. After adjusting for charity care grants, however, nonprofit hospitals provide just 6.10% of net patient revenue in charity care, about 35% less than the previous ratio because grants account for more than one third of charity care costs at nonprofit hospitals. Meanwhile, for-profit hospitals also provide less charity after this adjustment, but the difference is not as large. For-profit charity care falls 0.91 percentage points, or about 17%. That represents half the decrease seen in nonprofit hospitals.

Taking a look at the additional charity care provided by nonprofit hospitals—above what for-profit hospitals are already providing—equal to the tax savings of nonprofits, unreimbursed charity care[4] as a percent of net patient revenue at nonprofits is only 1.67 percentage points above for-profit levels.

For-profit hospitals are already providing charity care in an amount greater than 5% of net patient revenue, and nearly 4.5% after subtracting out charity care costs that are covered by grants. The amount of charity care provided by for-profit hospitals can be considered a baseline for comparing other hospitals, since for-profit hospitals are not providing charity care to achieve tax-exempt status.

While nonprofit hospitals provide slightly more charity care than their for-profit counterparts, this is at the cost to the community of lost tax revenue from tax-exempt status. The charity care provided by nonprofit hospitals above the level provided by for-profit hospitals amounts to only 1.67% of net patient revenue after accounting for grants. While net patient revenue can vary greatly by hospital size and because of other factors, the average net patient revenue among nonprofit hospitals in Texas is $182 million. This implies nonprofit hospitals provide, on average, $3 million more annually in unreimbursed charity care than the average for-profit hospital.

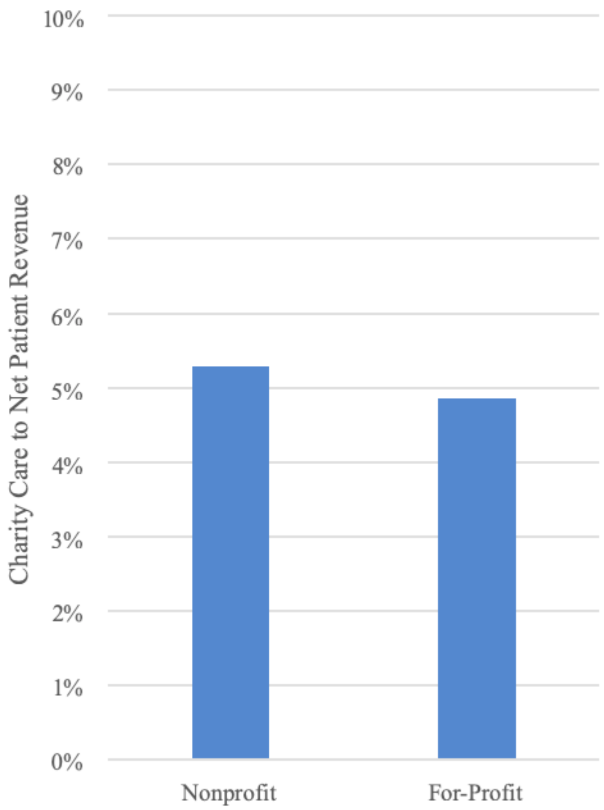
1 Rural areas as defined by the Health Resource & Service Administration (HRSA) are areas of less than 50,000 residents (HRSA, 2022).

2 Hospitals are determined compliant if both inpatient and outpatient codes and prices for all of the following were posted online and easily accessible to the public: cash rate, commercial rate, and Medicare rate. These data were compiled using records from Health Cost Labs and were collected in May 2022.

3 The amount of charity care measured here is based on the cost of care absorbed by the hospital, not the amount of patients served or the procedures performed.

4 Unreimbursed charity care is the dollar amount of the care provided by the hospital that neither the patient nor any other entity paid the hospital for.

Figure 3
Charity Care Ratios Normalized for Efficiency



Note. Produced using data from personal communication, Baker Institute at Rice University, March 2022, and authors' calculations.

However, there is a noticeable difference in efficiency between for-profit hospitals and their nonprofit counterparts. Judging by the ratios of operating expenses and charity care costs to net patient revenue, charity care grants, and charity care payments, nonprofit hospitals are less than 80% as efficient as for-profit hospitals. For every dollar spent by the average for-profit hospital, the average nonprofit hospital spends $1.27, over 25% higher. This means that a dollar spent on charity care in a nonprofit hospital will be spent less efficiently, and therefore provide less care, than if that same dollar were spent on charity care in a for-profit hospital.

If the charity care grants currently allocated to nonprofit hospitals were moved to for-profit hospitals, the total amount of charity care provided would increase, all else being equal. Such a change would increase efficiency, thereby reducing operating expenses by an average of 21%. That far exceeds the total amount of charity care provided by those nonprofit hospitals and is many times more than the relatively small amount of additional charity care nonprofit hospitals provide relative to for-profit ones. To be clear, only a portion of the 21% savings in operating costs would be converted into additional charity care.

To put this in perspective, for-profit hospitals use their funds so much more efficiently than nonprofit hospitals that $1 in charity care grants goes about 27% further in for-profit hospitals than nonprofit ones. After factoring in these efficiency gains, nonprofit hospitals are effectively providing less than 9% additional charity care than for-profit hospitals, with ratios of 5.29% and 4.86%, respectively, normalized for efficiency differences. While this does argue that non-profit hospitals are providing more charity care than for-profit hospitals, the difference is marginal, and they are doing so less efficiently with the dollars they retain from their tax exemption, a benefit for-profit hospitals do not enjoy.

For the average nonprofit hospital with nearly $182 million in annual net patient revenue, this additional charity care amounts to just $783,000 per year, a mere 0.43% of net patient revenue. The logical question that arises is whether communities are getting their money's worth for the foregone tax revenue from granting these hospitals nonprofit status. Giving that question a definitive empirical answer requires data on property tax assessments for nonprofit hospitals. Nevertheless, it is highly unlikely that the tax savings of the average nonprofit hospital are less than $783,000 given the size of their self-reported budgets, which average $200 million (Baker Institute at Rice University, personal communication, March 2022; authors' calculations).

The analysis of nonprofit and for-profit hospitals can also be broken down by location. After accounting for the size difference in rural and non-rural hospitals, we find that charity care from nonprofit hospitals is provided at a significantly higher rate in rural areas. In fact, rural nonprofit hospitals provide charity care at a rate four times higher than that of what rural for-profit hospitals provide. After adjusting for efficiency differences, in non-rural areas, for-profit hospitals provide unreimbursed charity care equal to 4.87% of net patient revenue, while nonprofits in the same areas provide charity care at a rate of 5.19%, only .32 percentage points more. Conversely, rural nonprofit hospitals provided 1.25 percentage points more charity care than their for-profit counterparts.

Rural nonprofits are also much more efficient than nonprofits in non-rural areas. Rural nonprofits spend only slightly more than for-profit hospitals in those same areas. Meanwhile, the inefficiencies at nonprofits in non-rural areas are significantly worse than those in rural areas. Non-rural nonprofits spend 27 cents more per dollar than for-profit hospitals do in the same areas.

The same comparison can be drawn between hospitals that are compliant or not with price transparency rules, which require hospitals to post their pricing for all shoppable services and negotiated rates.[5] If their website does not include a complete listing of these prices as the law requires, they are considered non-compliant. Because both groups have similar proportions of for-profit/nonprofit and rural/non-rural hospitals, their results are similar. After removing grants, unreimbursed charity care is 6.03% for compliant hospitals, and 5.51% for non-compliant ones, a difference of 0.51 percentage points. Simplified, this means that there is not much of a difference in charity care provided by non-compliant nonprofit hospitals and non-compliant for-profit hospitals. However, there is more divergence within compliant hospitals, where for-profit hospitals have a charity care ratio of 4.11%, while the ratio for nonprofit ones is 7.12%, a difference of 3.01 percentage points, more than double the difference for noncompliant hospitals. In other words, most of the difference in unreimbursed charity care between nonprofit and for-profit hospitals comes from the compliant group. In this compliant group, nonprofit hospitals give more charity care than for-profit hospitals. This suggests that the differences between nonprofit and for-profit hospitals may be minimized by noncompliance and maximized by price transparency.

While our study is specific to Texas, North Carolina State Health Plan and Johns Hopkins Bloomberg School of Public Health (2021) recently conducted a similar study in North Carolina. They concluded that while the state's largest nonprofit hospital systems received tax breaks estimated to be worth more than $1.8 billion in 2019–2020, spending on charity care provided to North Carolinians did not exceed even 60% of that amount.

Given that such discrepancy is not exclusive to the state of Texas, it is imperative that all states implement policy that ensures nonprofit hospitals are held accountable for providing the charity care their tax-exempt status requires them to deliver better proportioned to their net patient revenue. Texas has the opportunity to be an example to other states to enforce existing legislation or implement new legislation that ensures nonprofit hospitals are held accountable for the charity care they are required to provide the community, especially by comparison to the charity care provided to for-profit hospitals that do not enjoy such status.

Conclusion

Nonprofit hospitals enjoy the benefits of tax-exempt status while not providing a proportional amount of community benefit through charity care. This is evident through the lack of drastic deviation between the charity care of nonprofit and for-profit hospitals, and through the efficiency differences between the two types of hospitals.

This issue extends across the nation and some states have tried to fix it. Texas has the existing statutory requirements it needs to ensure that nonprofit hospitals are providing sufficient amounts of charity care, but it must be enforced. If they are not meeting these requirements nor exceeding the amount of charity care that for profit hospitals are providing, they should no longer enjoy tax exempt status consistent with the law.

5 Price transparency rules as according to SB 1137 from the 87th Texas Legislature, 2021. Data collected from Turquoise Health and calculated by the author.

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